



State of Washington
Department of Revenue

Excise Tax Advisory

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TAXABILITY OF INVESTMENT INCOME

Issued: June 30, 1995

This bulletin is a clarification and not a change of the Department's position on the taxability of income from investments. RCW 82.04.4281 gives a deduction from the measure of the business and occupation (B&O) tax for amounts received from investments or the use of money as such for taxpayers not engaged in banking, loan, security, or other financial business. This bulletin explains how this deduction applies in some situations.

A two part inquiry is used to determine if the taxpayer is a "banking, loan, security, or other financial business". The first inquiry requires determining whether the primary purpose and objective of the taxpayer is to earn income through the utilization of significant cash outlays or whether these activities are merely "incidental" to the taxpayer's nonfinancial business activities. This inquiry is made by applying a percentage test. The Department conclusively presumes that the income is not from engaging in a financial business, but is incidental to the nonfinancial business activities, if the financial income is five percent or less of the annual gross receipts. The percentage of financial income will be computed by including all calendar or fiscal year financial income from "loans and investments or the use of money as such" in the numerator, whether taxable, exempt, or deductible, and including all calendar or fiscal year revenues as normally measured by the B&O tax, including all revenues otherwise exempt or deductible, in the denominator.

If the first inquiry results in five percent or less of financial income in each of the years, it is unnecessary to proceed to the second inquiry. The taxpayer will not be considered as engaging in a "financial business". If the percentage exceeds five percent in any of the years, it is necessary to proceed with the second inquiry, but only for those years in which the percentage exceeds five percent.

ETBS have been made Excise Tax Advisories, and have retained their old number. Advisories with a 2 (plus three digits) are new advisories, ETBs that have been revised and readopted after review under the Department's regulatory improvement program, or advisories that have been revised and/or readopted.

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The second inquiry for determining when a taxpayer's activities constitute a "financial business" involves whether the taxpayer's activities are similar to, or comparable to, those of "banking, loan, [or] security businesses", even though the taxpayer might not technically fall within one of those three categories. The factors which will be considered include, but are not limited to, the source of the income, frequency of investments, volume of investments, percentage of income from investments in relation to the total income of the business, and the relationship of the investment income to the other activities of the business.

For a business activity to be considered "similar" and "comparable" to "banking, loan, [or] security" businesses, the activity must be regular and recurrent. Indicia of regular and recurrent activities "similar or comparable" to those of a "banking, loan [or] security business" include, but are not limited to: (1) For a bank and loan business: the making of loans on a continuing basis. (2) For a securities business: (a) a diversified portfolio, (b) a need for expertise, whether from an internal or external source, in the selection and management of investments; and (c) trading activities.

"Investments or the use of money as such" encompasses not only investment activity, but also lending activity, or a combination of both lending and investment activities. However, businesses who sell merchandise on an installment basis and directly carry these accounts receivable are not considered as receiving the interest from investments or the use of money as such. The interest received from these transactions is directly related to the sale of the merchandise and the deduction for "investments or use of money as such" does not apply. This interest is not related to a banking, loan, security, or other financial business activity with respect to these transactions. (See WAC 458-20-109.)

SPECIAL APPLICATION TO SOLE PROPRIETORS/INDIVIDUALS:

It is the Department's position that an individual is not engaged in a banking, loan, security, or other financial business if the individual is not engaged in any business activity which would require the individual to register with the Department. If the only source of income by an individual is from investments or interest from loans or deposits, the individual is not considered to be engaged in a business activity and is not required to register with the Department, regardless of the amount of income or volume of investments or loans. If a sole proprietor is engaged in a business activity which requires registration, it is necessary to apply the two inquiries indicated above.

If an individual has made investments in the past and later starts a business, any continuing income from investments which were made prior to starting the business will not be taxable. This income may be excluded from the numerator and the denominator in computing the percentage discussed above. Changes in these investments will continue to not be taxable if the investments are unrelated to the sole proprietor's current taxable business activities.